

Senate Bill 702 (Peace) Chapter 935
Clarification of ban on "For Export Only" cigarettes

Urgency, effective October 12, 1999. Amends Sections 30163 and 30436 of Revenue and Taxation Code.

Requires the Board to revoke the license issued to a distributor if the packages in which the cigarettes are contained are:

- 1. labeled "For Export Only", "U.S. Tax Exempt", "For Use Outside U.S.", or similar wording indicating that the manufacturer did not intend that the product be sold in the United States,**
- 2. altered by adding or deleting the wording, labels, or warnings, or**
- 3. imported into the United States after January 1, 2000, in violation of Section 5754 of Title 26 of the United States Code.**

This bill also authorizes the Board to seize the cigarettes that are in violation of the stamping restrictions contained in Section 30163.

Sponsor: California Distributors Association

Law Prior to Amendment:

Under current law, Section 30163 of the Cigarette and Tobacco Products Tax Law prohibits the affixing of any cigarette tax stamp to any package of cigarettes unless that package complies with all requirements of the Federal Cigarette Labeling and Advertising Act (15 U.S.C. Sections 1331-1341) for the placement of labels, warnings, or any other information upon a package of cigarettes that is to be sold within the United States. This section requires the Board to revoke the license of any distributor who affixes a stamp to these cigarettes manufactured for export outside the United States.

Current Section 30436 authorizes the Board to seize cigarettes not contained in packages to which the California cigarette tax stamp is affixed or tobacco products upon which the surtax has not been paid, if the seller is not authorized to sell such unstamped cigarettes or ex-tax tobacco products. Upon seizure, those items become the property of the state.

Beginning January 1, 2000 federal law, as amended by the Balanced Budget Act of 1997 will prohibit the sale of "for export only" cigarettes in the domestic market. However, inventories of "for export only" cigarettes will be allowed to be sold provided the distributor has paid the federal excise tax.

In General:

Most American cigarette manufacturers market two different types of cigarettes: cigarettes for domestic sale and cigarettes for export to other countries. It is Board staff's understanding that the cigarettes are essentially identical products. Because these cigarettes can be purchased at a reduced price, some California distributors have been importing "for export only" cigarettes back into this state, paying federal and state taxes and duties, and selling those cigarettes. The price differential between domestic and export cigarettes averages \$6 per carton. These gray market cigarettes currently comprise approximately 10% of the market share of reported cigarette sales in California.

Background:

The current restriction on the distribution of cigarettes in California that do not meet all the requirements of the Federal Cigarette Labeling and Advertising Act was amended into Section 30163 last year by Senate Bill 2134 (Ch. 292) and sponsored by the California Distributors Association. The sponsor's asserted that these "for export only" cigarettes, which are marketed by American cigarette manufacturers for foreign markets, were smuggled back into California and have become associated with export fraud, smuggling, and organized crime. Their bill was intended to deter the increasing volume of contraband cigarettes sold in California. In spite of the restriction placed into the cigarette tax law by SB 2134, "for export only" cigarettes continue to be available in California because these cigarettes *do* comply with the Federal Cigarette Labeling and Advertising Act, which basically requires health warning labels.

Comments:

1. **Purpose.** This bill is intended to clarify the definition of export tobacco products subject to the stamping restrictions in current law and give the Board the authority to seize the cigarettes found to be in violation of those restrictions.
2. **Pending federal law would not be adequate.** Effective January 1, 2000, federal law will require export cigarettes to be either re-imported to an export warehouse for eventual shipment outside the United States or shipped back to the manufacturer. However, any inventories of these cigarettes on hand as of December 31, 1999 would continue to be available for sale, even after January 1, 2000. There are indications that these inventories could become substantial and available for sale for a year or more after the federal law takes effect.

This bill would provide the state with the necessary immediate authority to eliminate these cigarettes from California. While the federal regulations are necessary to prohibit these gray market cigarettes in the long run, any delay in the enactment of this legislation in deference to the federal law change has a direct and negative impact on the state's revenue.

3. **The Board did not discover any cigarettes in violation of the federal labeling requirement.** The intent of last year's SB 2134, as understood and supported by the Board, was to restrict, through the revocation of a distributor's license, the cigarettes now more specifically targeted by this bill. Upon enactment, Board staff discovered that the reference to the federal act dealt with health warning labels. Since these cigarettes had the proper health warnings or distributors were adding the health warning labels to the packages sold in California, in conformance with the federal act, no distributors were violating the new stamping restrictions. Consequently, this measure is necessary to achieve the intent of SB 2134.
4. **The seizure authority would be consistent with other provisions.** The provision to authorize the Board to seize cigarettes which are stamped, but are sold in defiance of the restriction on the selling of "for export only" cigarettes in California, would allow the Board to enforce the restriction in a manner consistent with the seizure provisions on all other illegally distributed cigarettes in California.
5. **Foreign manufactured cigarettes would continue to be available.** This bill would only restrict the sale of domestically manufactured cigarettes that are packaged for export outside the United States. Cigarettes manufactured in Great Britain, as one example, would continue to be legally imported, stamped, and made available for sale. Distributors of foreign produced cigarettes would continue to be allowed to stamp and sell their products in California.